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January 7, 1998

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BY HAND DELIVERY

Magalie Salas, Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128

Dear Ms. Salas:

Please find enclosed for filing an original and fourteen copies of the RBOC/GTE/SNET Payphone Coalition's Opposition to Petitions for Reconsideration in the above-captioned proceeding.

Please date-stamp and return the extra copy provided to the individual delivering this package.

Sincerely,

Michael K. Kellogg

Michael K. Kellogg

Enclosures

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Implementation of the Pay Telephone	)	
Reclassification and Compensation	)	CC Docket No. 96-128
Provisions of the	)	
Telecommunications Act of 1996	)	

THE RBOC/GTE/SNET PAYPHONE COALITION'S OPPOSITION TO PETITIONS FOR RECONSIDERATION

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January 7, 1998

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EXECUTIVE SUMMARY

The Commission properly reaffirmed its commitment to a market-based default compensation rate for access code and subscriber 800 calls in its Second Report and Order. A few of the Petitions for Reconsideration criticize the Commission's avoided cost methodology; but the Commission has already rejected each such challenge to its Second Report and Order in denying the stay requests filed by MCI and PCIA. Most of the Petitions advocate alternative compensation mechanisms that favor their particular interest group, or simply rail against the need to pay fair compensation. Nothing in any of these Petitions undermines the Commission's decision to base the per-call default rate on the deregulated local coin rate, adjusted for differences in costs.

I. The Commission's avoided cost methodology was fundamentally sound. There can be no serious doubt that the Commission has been faithful to the D.C. Circuit's mandate. And it is equally clear that a market-based rate is superior to a cost-based rate. Indeed, only two parties persist in calling for a bottom-up, cost-based coinless rate, and they support their position with arguments that the Commission has already properly rejected time and again.

A number of petitioners drag out an assortment of proposals for alternative compensation mechanisms: based on measured rates, or calling party pays, or variations on these. But the Commission has already concluded that these suggestions (expressly rejected in the First Report and Order) are beyond the scope of this remand proceeding; there is no reason for the Commission to reconsider the per-call compensation mechanism so late in the day.

II. The RBOC/GTE/SNET Payphone Coalition ("The Coalition") has explained its disagreements with the Commission's application of the avoided cost methodology in its own petition for reconsideration. See Coalition Petition for Reconsideration at 8-21. The Coalition there demonstrates that a proper avoided cost calculation indicates that the coinless rate should be higher, not substantially lower, than the deregulated local coin rate of $.35.

AT&T now points to several alleged flaws in the Commission's calculations that, AT&T predictably argues, raised the default rate too far. None of these criticisms hits its mark. First of all, the Commission did not rely "almost exclusively" upon IPP data as AT&T claims. While the IPP data was the basis for the Commission's marginal call volume calculation -- which AT&T never says is wrong -- the Commission relied on data provided by a number of parties (AT&T and the Coalition included) for its avoided cost calculation, and for its bottom-up "reasonableness" check as well. The Commission properly declined to rely on the data provided by Sprint and the data from a single state's rate-making proceeding, as the Commission has already explained. The "Project Quintet" data which AT&T now introduces in an attempt to discredit the Commission's efforts omit important categories of costs and fails to reflect a business and regulatory environment that has changed significantly since 1994. When the data is appropriately adjusted, it reflects a per-call cost of $.363 per call.

The Commission's decision to use $.35 as the deregulated market baseline is unassailable. AT&T's arguments that the Commission failed to account for profit in performing its adjusted cost calculation is demonstrably wrong, as is its claim that the Commission should have used a higher deduction for local call completion costs. And while the ANI ii data upon which the Commission relied now appears to have been flawed, AT&T's suggestion that no adjustment should be made for these costs is clearly incorrect.

III. Finally, the Commission has been bombarded with pleas from businesses who object to the deregulated payphone environment, in which they must pay for the payphone services they choose to consume. But it was Congress that decided that the free ride that IXCs and callers alike have been taking on PSPs' investment should come to end. The special-interest pleading thus raises no substantial objection to the Commission's action; their complaints are with Congress, not the Commission.

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter of

Implementation of the Pay Telephone	)	
Reclassification and Compensation	)	CC Docket No. 96-128
Provisions of the	)	
Telecommunications Act of 1996	)	

THE RBOC/GTE/SNET PAYPHONE COALITION'S OPPOSITION TO PETITIONS FOR RECONSIDERATION

The RBOC/GTE/SNET Payphone Coalition has filed a Petition for Reconsideration of the Commission's Second Report and Order in this rulemaking proceeding. In that petition, the Coalition expresses its firm support for the Commission's decision to adopt an avoided cost approach to calculating per-call compensation, while pointing out several flaws in the Commission's application of that methodology that should be corrected on reconsideration.

In this Opposition, the Coalition takes issue with the arguments raised by AT&T and other petitioners who argue that the $.284 default rate is too high, either in general, or as applied to their special case. These arguments fall into three categories: those that challenge the Commission's methodology, those that challenge the application of that methodology, and those that amount to loud complaints about the injustice of requiring payphone users to pay for the services they choose to use. We discuss these arguments in turn.

I. THE COMMISSION'S AVOIDED COST METHODOLOGY WAS FAITHFUL TO THE D.C. CIRCUIT'S MANDATE AND WAS FUNDAMENTALLY SOUND

Challenges to the Commission's avoided cost methodology fall into two categories: those that attempt to raise from the dead the argument that the Commission had no choice but to use cost-based methods to calculate a default rate, and those that propose unprecedented schemes designed -- unsurprisingly -- to reduce the burden of per-call compensation on the petitioner's particular interest group. None of these challenges should be taken seriously.

A. The Second Report and Order Fulfilled the Court's Mandate

Alone among the petitioners, AT&T argues that the Commission misread the D.C. Circuit's opinion in Illinois Public Telecommunications Association v. FCC, 117 F.3d 555 (D.C. Cir. 1997), pet'n for cert. filed No. 97-1072 (Dec. 29, 1997). But it is AT&T that is guilty of careless reading. Contrary to AT&T's claims, the Commission never read the D.C. Circuit's opinion as endorsing a market-based approach for setting the default rate for coinless calls; rather, the Commission, after "careful review," found nothing in the court's opinion that precluded the Commission from linking the default coinless rate to the market-determined local coin rate. Second Report and Order, CC Docket No. 96-128, FCC 97-371, ¶ 23 (rel. Oct. 9, 1997). Of course, AT&T does not -- and indeed cannot -- dispute this fundamental point.[1]

Contrary to AT&T's suggestion, the Commission was absolutely faithful to the court's mandate on remand. The Commission directly addressed the court's sole criticism of its choice of the deregulated local coin rate as a surrogate for the coinless rate: that the Commission had failed to account for differences in the costs of coin calls and coinless calls. See Illinois Pub. Telecomm., 117 F.3d at 563-64. Far from making only "minor modifications," AT&T Petition at 3, the Commission accounted for cost differences and adjusted the per-call rate downward by nearly 20 percent.[2] AT&T's claim that the Commission failed to address the court's concerns is transparently false.

B. The Commission's Avoided Cost Methodology Was Fundamentally Sound

A few parties also criticize any use of an avoided cost methodology in this context. AT&T claims that such a methodology is "internally inconsistent and contrary to sound economic theory" because local coin calls and coinless calls are "two independent markets." AT&T

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[1]Indeed, despite AT&T's vehement arguments, the court never even suggested that the Commission was obligated to employ a cost-based methodology in setting the default rate. See Coalition Comments on Remand at 8 (filed Aug. 26, 1997).

[2]A proper calculation would have resulted in an upward, not a downward, adjustment.

Petition at 4-5 (emphasis removed). AT&T also claims that the relationship between the buyer and seller is different in the two markets because, in the case of local coin calls, the caller and the PSP agree upon a price, while in the latter case, the caller allegedly has no incentive to select less expensive payphones.[3]

These arguments will sound familiar to the Commission, because MCI has already raised them before the Commission in its Request for Stay (filed Nov. 13, 1997). The Commission rejected MCI's request, and has every reason to dismiss AT&T's rehashing of those arguments out of hand. The avoided cost methodology the Commission applied is an accepted regulatory technique for adjusting prices to reflect costs, one that ensures that "each call placed at a payphone . . . bear[s] an equal share of joint and common costs." Second Report and Order ¶ 42.[4] The technique has the endorsement of economists for its success in mirroring market results. See, e.g., Coalition Comments on Remand, Hausman Decl. at 7. (The Coalition has pointed out that the Commission could have mirrored market results even more closely had it taken demand conditions into account; that analysis shows that the avoided cost methodology, as applied by the Commission, tends to set the default rate for coinless calls too low. See Coalition Petition for Reconsideration at 3-8.)

Nor is there any merit to the claim that the markets for coin calls and coinless calls are so unrelated that the market-determined price in one market cannot be used to determine a proper default rate in the other. First, as the Commission has already pointed out to the D.C. Circuit, there are far more similarities than differences between the two markets. See Opposition of Federal Communications Commission to Motion for Stay, etc., at 7-8 (D.C. Cir. No. 97-1675,

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[3]The Consumer-Business Coalition echoes this argument. See The Consumer-Business Coalition for Fair Payphone-800 Fees ("C-BC") Petition at 19-20. Mtel also makes the conclusory claim that "the cost of 1-800 calls varies so widely that the 'one size fits all' approach adopted by the Commission is not here reasonable," Mobile Telecommunications Technologies Corp. ("Mtel") Petition at 7, but chooses not to elaborate further.

[4]Congress has mandated a similar method for calculating the wholesale rate for services sold for resale. See 47 U.S.C. § 252(d)(3).

Dec. 8, 1997). Moreover, petitioners never even suggest why the Commission was wrong when it determined that all calls, including coinless calls, should bear an equal share of the joint and common costs of the payphone. Certainly, IXCs would prefer to continue to take a free ride on PSPs' investment, but this would be plainly inconsistent with federal law. See 47 U.S.C. § 276(b)(1). Any alleged differences between the market for coin calls and coinless calls do nothing to undermine the Commission's methodology, which was designed to ensure that each call bears its fair share of joint and common costs.

And it does not take an economist to see that AT&T's claim that the Commission's methodology will give PSPs an incentive to raise their local coin rates is wrong. As AT&T concedes, 70 percent of payphone calls are local coin calls. Because the market for such calls is competitive, any increase from the competitive market price will reduce call volumes and, consequently, PSPs' profits. Only under truly unbelievable demand conditions would AT&T's prediction hold true. Cf. Coalition Petition for Reconsideration, Hausman Decl. Moreover, there is no reason to believe that IXCs will be unable to negotiate a lower rate for subscriber 800 calls from some PSPs -- independent of the local coin rate -- because of their ability to block calls.

Mtel claims that the Second Report and Order is flawed because the Commission's "carrier pays" compensation mechanism is premised on the availability of call blocking, and that IXCs are allegedly unable to block calls from some payphones. See Mtel Petition at 2-6; see also Source One Wireless II Petition at 3-4. First of all, Mtel itself has already announced that it is blocking payphone calls. See Mike Mills, That New Number: 1-800-BLOCKED, Wash. Post, at B11 (Dec. 3, 1997); Coalition Opposition to PCIA's Request for Stay, at 5-6 (filed Dec. 9, 1997). Moreover, the Commission has already had an opportunity to consider, and to reject, this argument because it was raised by PCIA in its request for stay. The avoided cost methodology simply does not depend on the availability of call blocking: "the establishment of a default per-call compensation rate was itself intended to redress the possibility of unequal bargaining power between PSPs and carriers." Memorandum Opinion and Order, Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket 96-128, DA 97-2622, ¶ 8 (rel. Dec. 17, 1997) ("Dec. 17 Order"). Per-call compensation was necessary on coinless calls to ensure compensation for "each and every" call, as Congress required; no party can dispute this. And no party poses any serious challenge to the Commission's conclusion that over time IXCs' ability to block calls will give them and their customers significant leverage to negotiate lower rates. See Second Report and Order ¶ 97. Certainly, their negotiating position is stronger than that of the PSPs, who are prohibited from blocking access code and subscriber 800 calls. See Memorandum Opinion and Order, Implementation of Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, DA 97-2565 (rel. Dec. 5, 1997) ("Dec. 5 Order") (rejecting MCI's request for stay).[5]

C. The Commission's Avoided Cost Methodology Was Superior to the IXCs' Proposed Cost-Based Approaches

AT&T and the Consumer-Business Coalition continue to argue that the Commission was required to employ TELRIC or other cost-based calculations to arrive at the default coinless rate. The Commission has properly rejected these arguments time and again and should do so once again here.

The C-BC bases its call for application of a TELRIC standard on the premise that "for all relevant purposes, the payphone marketplace is analogous to the local exchange marketplace." C-BC Petition at 24. But even assuming that TELRIC is a valid methodology for pricing of unbundled network elements, the C-BC never refutes the Commission's conclusion that the

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[5]The Consumer-Business Coalition argues that the Commission was wrong to rely on competition in the market for local coin calls because there is unlikely to be competition at the point of sale for payphones. See C-BC Petition at 18-22. But the argument that "locational monopolies" prevent the development of price competition in the payphone market has already been rejected by the Court of Appeals, and is without merit for the same reasons that the Commission and the court rejected it the first time around: in the payphone market, multiple players and low barriers to entry and exit will keep prices at a reasonable level. See Illinois Pub. Telecomm., 117 F.3d at 562.

payphone market not only is already characterized by the presence of multiple PSPs, but is likely to become even more competitive in the future because of the ease of entry and exit into the market. See Second Report and Order ¶¶ 94-95.

AT&T's arguments are not only wrong, they are disingenuous. For example, AT&T begins by flatly stating that "it was precisely the failure of the First Report and Order to set a cost-based rate for subscriber 800 and access code calls that led the court to vacate the initial cost rate regulations." AT&T Petition at 7. Of course, the court held no such thing, as AT&T well knows: it was the failure to account for cost differences between coin calls and coinless calls that concerned the court. Illinois Pub. Telecomm., 117 F.3d at 563-64. Likewise, AT&T's allegedly indisputable claim that a bottom-up cost calculation would yield fair compensation is not only disputable, it has been disputed and conclusively refuted. The Commission noted that the cost studies it had reviewed "could leave PSPs without fair compensation for payphone calls," Second Report and Order ¶ 92, and that "reliance on costs studies . . . could reduce the revenue recovered by the PSPs, and therefore, might reduce the number of payphones deployed" in derogation of Congress's intent. Id. ¶ 93. The Commission therefore not only could, but did dispute AT&T's claim that a cost-based rate would lead to efficient payphone deployment. See also Coalition Petition, Hausman Decl. ¶¶ 9-12.

Indeed, at times AT&T shows that it has missed the point of the extensive proceedings in this rulemaking completely. For example, AT&T debates the merits of various cost-based approaches, see AT&T Petition at 8, seemingly unaware that the Commission's decision to adopt a market-based pricing approach means that it need not attempt "the difficult allocation" of joint and common costs that a cost-based proceeding would require. Second Report and Order ¶ 96. AT&T claims that a too-low default rate poses no threat to the efficient deployment of payphones because PSPs have not hitherto been compensated for most coinless calls, ignoring the fact that, pursuant to Commission Orders, LECs eliminated hundreds of millions of dollars in subsidies formerly used to support their payphones. See Dec. 5 Order ¶ 12; cf. AT&T Petition at

10. And AT&T continues to ignore other evident administrative problems with cost-based approaches, see, e.g., Coalition Petition, Hausman Decl. ¶ 9, while trying to reargue the D.C. Circuit's holding on the competitiveness of the local payphone market. See AT&T Petition at 10-11.

In short, nothing contained in any of the Petitions should undermine the Commission's determination to set a market-based default rate. Nor is it likely to, for as the Commission has already held, "[o]n remand, the Commission considered alternatives to the market-based approach to establish a default rate, but rejected them as not required by the court's remand or by the statutory standards, and as inferior to its chosen approach." Dec. 5 Order ¶ 6.

D. Other Compensation Mechanisms Are Outside the Scope of These Proceedings

Several parties have asked the Commission to reconsider its basic decision to establish a per-call default compensation rate, its decision to establish a uniform default rate for both access code and subscriber 800 calls, or its decision to adopt a "carrier pays" compensation mechanism.

The Commission declined to address these issues in the Second Report and Order because they were beyond the scope of the issues raised in the remand phase of this proceeding. See Second Report and Order ¶ 132; Public Notice, Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding, CC Docket No. 96-128, DA 97-1673 (rel. Aug. 5, 1997) ("Public Notice"). And the bedraggled arguments the various parties parade before the Commission do not warrant any change of course.

1. The Argument for "Calling Party Pays" Is Foreclosed

Source One, PageMart, and the Dispatching Parties all argue in favor of some form of "calling party pays" compensation mechanism. See Source One Petition, at 5-9; PageMart Wireless, Inc. Petition at 6-9; Dispatching Parties Petition at 4-7. See also Direct Marketing Ass'n Petition at 5. The Source One Petition summarizes the arguments as well as any: they argue that carrier pays is "cumbersome," that the Commission wrongly concluded that it is the 800 subscriber, rather than the caller, that is the primary economic beneficiary of subscriber 800 calls, and that calling party pays gives more appropriate economic incentives to callers. One need look no further than the D.C. Circuit's opinion in Illinois Pub. Telecomm. to see that these arguments are dead in the water. See 117 F.3d at 566-67. The court rejected each one explicitly. There is simply no reason for the Commission to reconsider the merits of its decision when it has been explicitly upheld once already. See Second Report and Order ¶ 132.[6]

2. The Commission Properly Rejected Proposals for Measured Use Compensation

Every completed call made from a payphone shares one essential characteristic: if not for the PSP's investment, the call could not have been made. It is hardly surprising that the Commission therefore decided that all payphone calls should bear their fair share of the costs of providing the payphone. See Second Report and Order ¶ 42.

Paging companies, who believe that the calls their customers make tend to be shorter than other dial-around and subscriber 800 calls, ask the Commission to discard the per-call compensation approach. The Commission has appropriately refused to do so once in the Second Report and Order and should do so again here. First, the D.C. Circuit has already implicitly approved the per-call compensation approach when it rejected the challenge to the carrier pays mechanism. See Illinois Pub. Telecomm., 117 F.3d at 567 ("[T]he Commission's conclusion that a 'carrier pays' compensation system will result in competitive market pricing of 800 service payphone per-call compensation charges was not arbitrary or capricious." (emphasis added)).

Second, the Commission was well within its discretion to conclude that each completed call, whatever its duration, should bear an equal share of the joint and common costs of the

[6]The parties suggest an array of variations on the basic "calling party pays" mechanism, including those who advocate what the Commission referred to in the Second Report and Order as the "AirTouch Plan," under which certain numbers would have full payphone access and others would require the caller to pay for payphone access. See Dispatching Parties Petition at 5-7; PageMart Petition at 8-9. The Commission need not consider these suggestions at this time, but it is worth noting that the parties may be able to implement some of these plans on their own. For example, paging companies might sell services with and without payphone access; they also might utilize local numbers, or toll numbers: both would require the calling party to pay for payphone access. One thing seems certain: in the new payphone marketplace, a variety of solutions will arise, without the need for the Commission's intervention.

payphone. This is already the situation in the local coin market, where the basic rate is the same -- whether the completed call lasts 5 seconds or 5 minutes -- with additional charges imposed for the longest calls.

The arguments of PageNet and PageMart that per-call compensation is unfair amounts to no more than special interest pleading. For example, PageNet sanctimoniously claims that it "offends common notions of fairness" to require PageNet to pay 28.4 cents for a 30-second 800 call. Paging Network Petition at 7. To the contrary: it would "offend common notions of fairness" for PageNet to gain access to a payphone without paying its fair share of the costs. And PageNet's argument that compensation of 28.4 cents per 800 call is "grossly disproportionate" to the paging company's revenues simply underscores that such companies have been taking a free ride on PSPs' investments for years. As the Coalition has repeatedly pointed out, it was not the Commission that brought this free ride to an end, it was the Telecommunications Act of 1996.

3. No Party Presents Evidence of Cost Differences Between Different Types of Coinless Calls

Finally, PageMart and PageNet both argue that the per-call compensation mechanism fails to account for differences in costs between different types of coinless calls. See PageMart Petition at 4; Paging Network Petition at 12. But they present no evidence of any such general differences, nor do they describe how the Commission could have taken account of them in setting the per-call rate. The D.C. Circuit made clear that the Commission was required to take account of the differences in costs of local coin calls on the one hand and access code and subscriber 800 calls on the other. See Illinois Pub. Telecomm., 117 F.3d at 563-64. The Commission has done so.[7]

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[7]The C-BC and the Dispatching Parties express concern over fraud, and argue that such concerns justify excepting some calls from the "fair compensation" requirement. The simple answer to this argument is that fraud is a crime: the Coalition stands ready to do whatever it can to aid enforcement efforts intended to prevent and punish such fraud. Given IXCs' responsibility for tracking calls, the sorts of crude fraud that the Dispatching Parties allege will be easily stamped out, the claims of the C-BC notwithstanding. See C-BC Petition at 10.

II. THE 28.4 CENT RATE IS TOO LOW, NOT TOO HIGH

Only four of the Petitions for Reconsideration filed with the Commission actually present appropriate issues for reconsideration at this stage in the proceedings, that is, suggestions for refinements to the Commission's market-based methodology and its application. Three of those -- the Petitions of the Coalition, of Peoples, and of the APCC -- demonstrate that proper application of the avoided cost methodology leads to a default rate significantly above the 28.4 cent rate set by the Commission. One -- that of AT&T -- argues that the 28.4 cent rate is too high. AT&T is wrong.

A. The Commission Did Not Improperly Rely on IPP Figures to the Exclusion of Other Data

AT&T claims that the Commission relied "almost exclusively" on data provided by Independent Payphone Providers ("IPPs") in setting the per-call compensation rate. But this charge is unwarranted, for the Commission relied on data provided by the Coalition, by IPPs, and -- perhaps most of all -- by AT&T.

As an initial matter, AT&T's criticism again ignores the nature of the proceedings on remand. In its call for comments, the Commission asked for comment on "the differences in costs to the PSP of originating" coinless and coin calls. Public Notice at 2.[8] Thus the crucial data upon which the Commission relied were not "bottom-up" cost figures -- upon which AT&T is fixated -- but only those costs unique to local coin or coinless calls.

And in performing this avoided cost calculation, the Commission relied on data provided by AT&T more than that provided by any other party. For example, the Commission improperly included coin mechanism capital costs as an avoided cost, relying almost exclusively on misleading data provided by AT&T. See Second Report and Order ¶¶ 52-53; Coalition Petition for Reconsideration at 8-15. Coin mechanism costs were the largest single avoided cost in the

[8]The Coalition provided this data in detail, despite AT&T's charges to the contrary.

Commission's calculation, subtracting a full 3.1 cents from the local coin rate. See Second Report and Order ¶ 53. The Commission again relied on AT&T figures in calculating line charge savings; this was the second largest component of the avoided cost adjustment. See id. ¶ 54 n.141. And in calculating collection and maintenance costs, the Commission considered AT&T's data, but rejected it because of double counting. See id. ¶ 55 n.145. On AT&T's suggestion, the Commission wrongly refused to make any adjustment for bad debt and collection charges. See id. ¶ 56.

AT&T's objection to the Commission's reliance on IPP data is thus incredible. The one place where the Commission relied heavily on APCC data was in performing its "marginal payphone" calculation in paragraph 48 of the Second Report and Order. But this choice was entirely appropriate, because APCC represents independent payphone providers -- those who have been subject to market discipline -- nationwide. Moreover, AT&T never states that the Commission's estimate of call volumes for a marginal payphone is wrong. Instead it complains that IPP's per-call costs -- $.435 -- are too high, when the Commission simply did not credit this figure (after all, the per-call default rate is more than 15 cents less). And the importance of the marginal payphone calculation is easy to overstate in all events: it had no effect on the choice of the deregulated coin rate and it had no impact on the Commission's use of the Coalition's data, which was provided on a per-call basis.

Even if one were to focus, as AT&T does, on the Commission's bottom-up cost calculation -- which the Commission intended merely as a check on the reasonableness of its avoided cost figure, see id. ¶ 26 -- AT&T's complaints appear just as groundless. Indeed, the Commission noted at the outset of that calculation that "[t]hree parties, Peoples, CCI [both IPPs] and AT&T provided relatively consistent cost data." Id. ¶ 100 (emphasis added). In other words, the Commission found that AT&T's data agreed with the data provided by IPPs, data that AT&T now argues the Commission relied on too heavily. This may be the only proceeding in the

FCC's history where a party asks for reconsideration on the grounds that the Commission wrongly made the data that the party itself provided the cornerstone of its analysis.

AT&T also objects that the Commission rejected Sprint's data out of hand, but AT&T irresponsibly quotes the Commission out of context. The Commission rejected Sprint's cost estimate for SG&A (sales, general and administrative) as too low because of its organizational structure, see id. ¶ 103; but -- and AT&T conveniently ignores this point -- the Commission in other places declined to use Sprint data because it appeared to be too high. See id. ¶ 102 & n.272. The Commission explained its treatment of Sprint data in each case, and it clearly has the authority to reject data because it appears unreliable or is a statistical outlier. Likewise, the Commission properly and explicitly declined to rely on the New England Telephone cost study, which looked only at incremental costs for a single, non-representative PSP. See Second Report and Order ¶¶ 70, 110. See also Coalition Reply Comments on Remand at 27 (filed Sept. 9, 1997).

AT&T attempts to cast doubt on the Commission's calculation by presenting data from SBC's 1994 "Project Quintet" that it claims "conclusively demonstrates" that monthly PSP costs are lower than the Commission thought.[9] In fact, the data demonstrate the opposite. As the attached Andersen study explains in detail, the affidavit by David Robinson, attached to AT&T's petition, omits important categories of expenses and neglects to adjust the figures for changes in the payphone marketplace in the three years since the projection was prepared. See Report of Arthur Andersen LLP, dated January 7, 1998 ("Andersen Report") (attached hereto as Exhibit A).

First, AT&T failed to adjust the Project Quintet figures for return on assets (though Mr. Robinson has acknowledged in the past that such return must be included in any calculation, see Andersen Report at 3 & n.2). Next, the Project Quintet study -- because it assumed the sale of SBC's payphone unit to an established buyer -- did not include any general and administrative

[9]Again, because the Coalition performed an avoided cost calculation based on the market rate, these cost calculations are a side issue.

service costs. In addition, Mr. Robinson failed to adjust the Project Quintet study for ANI ii costs, for bad debt and collection expenses, and for understatement of depreciation expenses. Marketplace changes also affect the validity of the 1994 projection. The current access line charge for a dumb set is 60 percent higher than the "Project Quintet" projection. And commissions paid to property owners have increased as well. Finally, regulatory changes warrant a small downward adjustment that Mr. Robinson failed to make. See Andersen Report.

The bottom line is this: the Project Quintet figures may well have been appropriate for the purpose for which they were intended. But an uncompleted project begun in 1994 to forecast operational costs three years into the future for the purpose of establishing the value of a business should never have been used to establish per-call costs in 1997, particularly in light of significant intervening changes both in the regulatory environment and in the payphone marketplace. As the attached report demonstrates, Project Quintet figures can only be instructive to the extent they are modified to reflect 1997 business realities. When so modified, the figures in fact suggest that per-call costs amount to $.363. See Andersen Report at 7 (summarizing adjustments).[10]

B. The Commission Properly Found That the Local Coin Rate Is $.35

The Coalition believes that the Commission could have reached a better result in its avoided calculation by starting with average commissions on 0+ calls, rather than the local coin rate. But given the Commission's choice, its decision to use $.35 as the starting point for its avoided cost analysis was more than reasonable.

The Commission explained simply that it chose the prevailing rate in five of the seven states that have deregulated their local coin rates. The Commission would have been well within

[10]In addition, when Andersen, using current expense projections provided by SBC, duplicated the Commission's bottom-up cost methodology, it found that SBC's per-call payphone costs were equal to $.37, a number consistent with the adjusted "Project Quintet" figures, as well as earlier Coalition calculations. Cf. Coalition Comments on Remand, Andersen Report at 13-14 & n.14.

its discretion to choose this modal rate even if all the states concerned were of relatively similar size, but, as it happens, the combined population of the states with a $.35 rate was almost 10 times the combined population of the two $.25 states. See Second Report and Order ¶ 12 n.33; U.S. Dep't of Commerce, Statistical Abstract of the United States, 28 (116th ed. 1996). AT&T presents no new data to strengthen its claim that the $.35 rate is not representative.

C. The Commission's Treatment of "Profit" Was Correct

AT&T's accusation that the Commission "failed to account reasonably for the profits on avoided costs" is also plainly frivolous. The cost figures that the Commission used in carrying out its avoided cost calculation included, where appropriate, return on investment, which is what AT&T refers to colloquially as "profit." See, e.g., Second Report and Order ¶ 53 & n.139 (including the return on capital associated with avoided capital costs for coin mechanism). Though the Commission was wrong to treat coin mechanism capital costs as avoided in the first place, AT&T can be reassured that "the Commission expressly treated as avoided the profit associated with avoided capital costs." AT&T Petition at 17 n.27.

D. The Commission's Adjustment for Local Call Completion Was Too Large, Not Too Small

AT&T's objections to the Commission's treatment of line savings are frankly incomprehensible. In making that calculation, the Commission not only relied on the figure supplied by AT&T for its high estimate, it actually adjusted the figure upwards. And the low estimate was based on an average of the AT&T figure and the figure supplied by an IPP. In other words, AT&T virtually supplied the figure for line savings that it now criticizes.

And the criticism is entirely inapt. AT&T seems to suggest that even if PSPs purchase a flat-rated line -- which they do, presumably, because it is more economical -- they should be treated as if they had purchased a usage-based line. But there is no basis for such a counter-factual approach. PSPs must purchase a line for each of their payphones, and that line is clearly a joint and common cost, which must be shared by local calls and coinless calls alike. The PSPs' line payments will not permit "double recovery," as AT&T suggests. LEC PSPs are deregulated, stand-alone entities, that must cover the costs of the services they receive, just as IPPs do.

E. A Proper Adjustment for ANI ii Costs is $.0188 Per Call

As the Coalition has explained in its Petition, the Commission erred by allocating ANI ii costs to all calls, when it is undisputed that special ANI ii digits are being implemented solely for the purpose of per-call compensation and tracking on subscriber 800 access code calls. Those costs therefore should have been allocated to the 116 calls per month at a marginal payphone. See Coalition Petition for Reconsideration at 18-19 & Andersen Report at 10 & n.42.

AT&T repeats its argument that PSPs should have to bear ANI ii costs as "a set-up cost." But PSPs, like AT&T, must be allowed to recover costs from their customers, including 800 subscribers and access code callers. And because ANI ii costs are associated with those services alone, they are properly passed on to those customers.

AT&T also argues that the Commission should ignore ANI ii costs in light of new data presented to the Commission by USTA. But if the Commission simply adjusts its Order to account for the new data (and nothing else, after all, has changed) and corrects its mistake in allocating ANI ii charges to all calls, the per-call adjustment is increased from $.01 to $.0188.[11]

III. THE COMMISSION SHOULD IGNORE SPECIAL INTEREST PLEADING

Finally, the Commission has been asked to consider a series of arguments that do not challenge the Commission's methodology, and that do not challenge the Commission's application of that methodology, but that simply ask for special treatment. These pleas can and should be ignored.

The paging industry has perhaps been the most vocal of the special pleaders. Because these companies have been free-riding on PSPs' investment for years, they are particularly chagrined at the prospect of paying their own way. See Petitions of the Dispatching Parties, Mtel,

[11]Even if the Commission accepted AT&T's low-ball figure, the per-call adjustment would be in the neighborhood of $.005, a far from insignificant amount.

PageMart, Paging Network, and Source One. But the C-BC informs the Commission that the paging industry is not alone: the truckers would also prefer to continue to get something for nothing. Schneider National, Inc., for example, reports that its drivers make 176,000 subscriber 800 calls each month from payphones. See C-BC Petition at 7. For this, PSPs have been paid not one cent to date. And it will perhaps not be a surprise to learn that taxicabs, airlines, voice messaging services, and even Nabisco, Inc., all believe that they will suffer "significant and unfair financial losses" unless they are excepted from the fair compensation requirement that 47 U.S.C. § 276 imposes. See C-BC Petition at 6. See also Direct Marketing Ass'n Petition at 2 (arguing that the ability to make free use of a payphone to reach one's voice mail "uniquely serve[s] the public interest and warrant[s] special policy consideration").[12]

Obviously, no one likes to pay for what one is used to receiving for free, but the fact is that payphones cost money and if PSPs are not compensated for the services they provide, they will go out of business. No one -- not paging companies, not truckers, not motorists in distress, not even voice messaging services -- benefits if a sub-optimal default compensation rate leads to the widespread elimination of payphones. The Commission has recognized that, at a minimum, a default compensation rate must ensure that subscriber 800 calls pay their fair share of the joint and common costs of the payphone upon which 800 subscribers choose to depend. See Second Report and Order ¶ 42. The market will make adjustments, and if there are cheaper ways to deliver the same services, entrepreneurs will provide them. But the Commission has done no

[12]All of these parties ignore the fact that the determination of how -- and indeed whether -- to pass on per-call charges to end-users is a business decision of the IXCs. See Report and Order, 11 FCC Rcd 20541, 20584, ¶ 83 (1996). IXCs raised rates on 800 services across the board after the First Report and Order was released; AT&T announced that it did so to recover per-call compensation amounts. See AT&T News Release, AT&T Adjusts Business Long-Distance Prices to Offset New Payphone Costs (Apr. 30, 1997); David Rohde, AT&T Hikes Rates to Pass Along New Pay-phone Charge, Network World, March 3, 1997 at p. 6; "800" Data Toll Hike Hits Users, Communications Week, Aug. 18, 1997 at p.1. AT&T has never explained why it therefore needs to pass on per-call charges yet again, particularly when it has announced no decreases in 800 rates to reflect that decision. And no IXCs, so far as the Coalition is aware, has passed on to subscriber 800 customers the hundreds of millions of dollars of access charge savings they have realized as a result of payphone deregulation.

more than its clear duty under the statute in requiring that PSPs receive "fair compensation for each and every completed call" made from a payphone.

CONCLUSION

For the foregoing reasons, the Commission should deny the Petitions for Reconsideration filed by AT&T, the Consumer-Business Coalition, the Dispatching Parties, Direct Marketing Ass'n, Mtel, PageMart, Paging Network, and Source One.

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Report of Arthur Andersen LLP
Second Report and Order: Reply to Petitions for Reconsideration

Carl R. Geppert

January 7, 1998

Report of Arthur Andersen LLP
Second Report and Order: Reply to Petitions for Reconsideration

Arthur Andersen LLP was asked to prepare this report for the RBOC/GTE/SNET Payphone Coalition ("the Coalition") in response to AT&T's Petition for Reconsideration dated December 1, 1997. Specifically, we have reviewed the Affidavit of David C. Robinson and the calculations contained therein to determine whether Mr. Robinson's calculations accurately depict the Coalition members' operating costs. In summary, Mr. Robinson's reliance upon the unadjusted figures contained in Southwestern Bell Corporation's ("SBC's") 1994 Project Quintet study to approximate the cost of providing payphone service in 1997 is inappropriate. His calculations significantly understate Coalition members' current cost of providing payphone service. The following is a brief overview of the flaws in Mr. Robinson's computations (detailed discussions of each item containing specific examples follow this section):

- Omission of Expenses: In several instances, Mr. Robinson failed to include expenses that should have been included when calculating a fully distributed cost-based per-call compensation ("PCC") amount. In addition, Mr. Robinson did not adjust those figures in the Project Quintet documentation that are not indicative of the costs of current operations/business practices experienced by Coalition members and the payphone industry in general. Specifically, Mr. Robinson excluded or incorrectly calculated the following:
  - Return on assets
  - Common costs (e.g., legal, real estate, systems expenses, etc.)
  - ANI ii costs
  - Bad debt and collections expenses
  - Depreciation expenses